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Living With Tied Priority

Roger Bernhardt

First Bank v East W. Bank

The holding in *First Bank v East W. Bank* (2011) 199 CA4th 1309, 132 CR3d 267—because different lenders whose competing deeds of trust on the same property were both opened in the mail at 8 a.m. on Monday morning by the county recorder, they therefore had equal priority—is perfectly logical, if logic is how a system should operate, even though that rule is going to make life much more complicated for those who need to operate in that system. The case is reported on p 26 of this issue.

The Futility of the Common Law System

The original common law rule of priorities—that first in time is first in right (still enshrined in CC §2897)—was also completely logical, but nevertheless had to be replaced by recording statutes because that rule made it impossible for title searchers to do their jobs. No searcher can report to its client that an examination of the records showed that no prior negative events had occurred, but that nevertheless no assurance that the title was good could be given because it remained possible that some such negative event might have occurred that the searcher would not (and often could not) know about that rendered the title unmarketable. Of course, no rational purchaser would want to pay out her money for property subject to an exception for an unknown event hanging over its title. That situation was what led to the universal enactment of recording statutes.

The Superiority of Recording Acts

In theory, recording acts should offer the perfect correction to the common law problem of secret defects, whether the statutes are of the notice, race, or race-notice variety. See CC §§1169–1220. Under any of those variations, a purchaser who has searched the records up until the last moment and then has recorded her instrument at the next moment should be protected against all claims—even the unknown ones. Instruments that were previously executed and actually recorded will be discovered by the search, and in time to avoid being harmed by them (*i.e.*, by not paying the purchase price unless they are eliminated), and instruments that were previously executed but unrecorded will be defeated by the doctrine of bona fide purchaser (BFP) (*i.e.*, they will be held to have inferior status, either because our purchaser took without notice (under a notice act) or because she recorded first (under a race act), or because she did both (under a race-notice act)). Different recording statutes might occasionally produce slightly different outcomes in different variant circumstances, but all will give first place to the BFP who has followed the above advice of searching up until the last moment and then recording at precisely the next moment.

If affairs could always be actually handled that way, results would always be clear and acceptable. A purchaser (or her examiner or escrow officer) would, first, search through the appropriate existing indexes in the recorder's office; then, second, she would examine the stack of recently deposited but not yet indexed documents in the recorder's inbox. If the search was satisfactory (revealing no adverse information), then, third, still standing at the recorder's desk, she would close the escrow (symbolically taking the buyer's money out of one pocket and the seller's title documents out of the other and switching their locations), so that she could, fourth, then hand the title documents to the recorder for them to be recorded. (Finally, fifth, she would deliver the documents and the money to the appropriate recipients.) Titles would always be good because the searcher would simply not close whenever she discovered anything hostile in the records. Nor would there ever be any ties to worry about, since even if other persons were standing in the same line and holding potentially

adverse instruments, those people would always be in front of or in back of our title searcher, meaning that she would either get notice of them or they would get notice of her from simply performing the tasks described above.

The Decline of the Manual Recording System

Just as the common law rule of priorities ultimately became unworkable, as conveyancing changed from the feudal ceremony of livery of seisin conducted in public on the property itself (with the transfer of a clod of dirt in exchange for a promise of fealty or a peppercorn or rose at midsummer) into the modern delivery of a written (or computer-generated) deed exchanged in a private office (in a law firm or title company office nowhere near the property), the straightforward recording system, dependent on a human traveling down to the city hall recorder's office, manually looking through the official indexes, and waiting in line to continue the search and deposit the documents, also has become too archaic in modern, computerized times.

One of the deeds of trust in this case was given recorder number #20081595205, which means that it was the one million, five hundred ninety-five thousand, two hundred fifth document (or page) recorded in 2008 alone (and that was only on September 4, 2008). Waiting in lines and leafing through inboxes will not work in a system involving a huge number of documents—often more than a million documents in one year alone. Instead, large batches of instruments are shipped by the title companies for arrival at the county recorders' officers at 6 a.m., where they are then all opened at 8 a.m. The batches must be even bigger on Monday mornings, when the weekend mail is included. There is no way for the system or those working under it to say which documents arrived before others did. It is more practicality than laziness to say that all of the documents time-stamped at 8 a.m. will be deemed to have arrived at the same time for purposes of deciding when they were recorded and which ones were recorded first. Even if governments had surplus resources to throw at such concerns, how could they say whether a document dropped in mailbox A and taken out of the box later by the mail carrier was recorded before or after one dropped in mailbox B earlier in the day but taken out of it later, particularly when both envelopes were time-stamped by the recorder at 8 a.m. the day after? Declaring that they were recorded simultaneously is not a cop-out, but the only conclusion left standing with any respectability behind it, even if there is no real logic behind it.

Rival Approaches—The Time of Indexing

The lender in *First Bank* whose deed of trust was first indexed (a few days after it had been received by the recorder) argued—naturally enough—that priority should depend on time of indexing. The court rejected that contention on the ground that the function of indexing is to resolve constructive notice issues, not to determine priority of recording. 199 CA4th at 1314. That seems technically correct: In a race-notice jurisdiction, such as California, where to prevail over A, B must both take without notice and also record first, a B who did take without notice and who deposited her document at the recorder's office first should be the victor, whether or not her instrument was indexed before or after A's document. But the better reason for not using first to index as a tiebreaker is that it would make a racing outcome depend on the timing of acts that were not under the control of the parties. Parties may control when their documents get to the recorder's desk, but they do not control when the recorder adds them to its indexes. Apparently, the exact timing of when any particular instrument gets indexed is random, depending on the efficiency of a particular document examiner and the number of documents she is working on that day. See 199 CA4th at 1317. No less importantly, a purchaser cannot hold off paying the purchase price until she knows that the recorder's staff has indexed the document that she submitted.

Other Tiebreakers

Difficulties also beset most other solutions. Three years ago, the Nebraska Supreme Court broke a tie between a construction loan and a mechanics' lien that arose when two documents mailed in one envelope were both opened at the same time by holding that the outcome would depend on the intent of the parties (a decision that I commented on in an article for the American College of Mortgage Attorneys entitled "Simultaneous Priority," available on my website at www.RogerBernhardt.com). See *Borrenpohl v Dabeers Props. L.L.C* (Neb 2008) 755 NW2d 39, 43. But that solution could work only when both documents were

deposited by the same party, as happened in the Nebraska case; it could not possibly resolve a dispute arising between two different lenders who both intended to make first loans, as occurred in *First Bank*.

Nature of the Claims

Another principle that has been employed is to make the nature of the instrument or claim a relevant consideration. The priority of tax liens under [IRC §6323](#) seems to be determined on the principle of “ties go to the IRS” when both attach to an after-acquired asset at the same instant. See [Sullivan v U.S. \(In re Hulett Corp.\) \(Bankr ND Ill 2008\) 389 BR 610, 616](#). In California, judgment liens may all attach to a judgment debtor’s after-acquired property at the same time, but they are then subranked according to their respective dates of original creation. See [CCP §§697.380\(g\), 697.340\(b\)](#). On the other hand, mechanics’ liens—which all relate back to the same commencement of construction—are not further ranked, but are then left with equal priority. [CC §3134](#). But the situation of mechanics’ lienors is probably different enough from that of consensual mortgage lenders as to make a solution that one group can live with (tied, but superpriority) not that pleasing to the other.

Back to the Common Law

Technically, we might say that because no statute has explicitly repealed the common law rule of temporal priority, that principle continues to apply whenever a recording act does not displace it with a more specific solution. For example, if O transfers property to A (without recording), and then O transfers the same property again to B (also not recorded), the recording act does not apply (because no one ever recorded so as to trigger the statutes). Thus, B, as a subsequent purchaser or encumbrancer, may have taken without notice of A, but he also did not record first, as a race-notice act requires—meaning that A wins as the first taker. Because the recording act does not say that either of these mortgages was recorded first, it may have taken itself out of the picture.

But what is common law priority for rival deeds of trust? [Civil Code §2897](#) provides for priority of liens by time of “creation,” which would probably be the moment that the loan was funded. But the liens in *First Bank* were memorialized by deeds of trust, and the declaration in [CC §1054](#) that a grant takes effect from the time it was “delivered” appears to apply to deeds of trust as well as to deeds of fees. See [Cortez v American Wheel \(In re Cortez\) \(BAP 9th Cir 1995\) 191 BR 174, 178](#). The time of delivery might be different from that of creation. Further, under either standard, resolution of that timing issue probably requires the (self-interested) testimony of participants, and involves entirely off-record events, getting us back to the problem that no outside third party can know whether such steps are happening before or after her own steps, which is what led title searchers to demand changes in the common law system in the first place.

New Technologies?

Going in the opposite direction and looking for a 22d-century mechanism to solve this problem is also unlikely. True, electronic filing is now on the horizon, e.g., the [Electronic Recording Delivery Act \(Govt C §§27391–27399\)](#) and the [Uniform Electronic Transactions Act \(CC §§1633.1–1633.17\)](#), but those techniques cannot eliminate the risks of simultaneous priority unless the players are all willing to completely scrap the present way of recording. County recorders’ offices that currently accept electronic filings shut their computers down on weekends so as to keep those submissions on a parity with the instruments that come in by mail or by messenger. To eliminate ties, electronic filing would have to be the exclusive mechanism. (Even then, what happens to all of the submissions that arrived at a time when the official government computer had crashed or had gone down for a few hours?)

Going the Article Nine Route

One solution could work, although it would require a major change in habits. Real estate lending could follow the strategy of [Article Nine of the Uniform Commercial Code \(UCC\)](#), which allows secured parties to file financing statements before their debtors execute security agreements or they fund their loans. See [UCC §9–509; Com C §9509](#). Under this regime, a prospective lender can file a financing statement today, then wait a week or so to see where the document ranks in the official indexing system, and then decide whether to make a loan. Even if the Secretary of State’s office does not open or read its mail on weekends, prospective filers can

see all that they need to know, and thereby act accordingly. Real property lending and recording obviously work differently from commercial financing and filing, but real estate mortgagees could still make and record future advance mortgages to put themselves into a comparable position (although I do not hold my breath in anticipation of the industry taking up such an idea).

Living With Uncertainty

It is unlikely that we shall witness changes that effectively eliminate the risk of simultaneous priority that *First Bank* presents. Because that borrower got away with pocketing two loans at once, like-minded other sharpsters might start trying to do even better. Title insurers are going to have to get used to dealing with insured lenders who find their loans having only part of the priority they thought they had. (I would be tempted to say these new loans have mezzanine priority, but that elevation is already taken.)

Newly tied lenders will have to confront additional issues apart from the question of their title insurance coverage. Are their loans tied only in ranking or are they also tied together somehow (like tenancy-in-common or joint tenancy assets), requiring some sort of agreement between the lenders before any action can be taken? Will notices of default or sale have to be signed by both lenders (like community property documents have to be)? More seriously, when one loan goes into default—as is certainly going to happen—can it be independently foreclosed, *i.e.*, without involvement of the other? If there is a foreclosure, will the sale cover all or just half of the property? Can the entire sale proceeds be kept by the foreclosing lender or must they be shared with the rival?

I predict that lenders who find themselves in this predicament will be treated like co-payees of mortgage notes. Each will be allowed to foreclose without the consent of the other, as long as its particular loan is in default. But each will also be compelled to foreclose on the entire bundle of security, because it would be utterly impossible for anyone to calculate a bid on a property that continued to remain subject to a coordinate deed of trust. Each lender will have to share the bid proceeds on some kind of prorata basis with the other lenders, whether they joined in the foreclosure or not. Those are the only results that might work in these impossible circumstances.

Two deeds of trust secured by same property, delivered to recorder's office before business hours on the same day and time-stamped at the same time, shared equal priority even though they were indexed at different times.

First Bank v East W. Bank (2011) 199 CA4th 1309, 132 CR3d 267

Unknowingly, two banks loaned money to the same borrower on the same property and issued two separate, independent deeds of trust securing that property. Two different title insurance companies delivered the trust deeds to the local recorder's office before business hours on the same day. Both trust deeds were dated and time-stamped at the same time (8:00 a.m.) on the same day (September 4, 2008). The two trust deeds were indexed 2 days later, but the one in favor of East West Bank was indexed nearly 4 hours earlier than the one for First Bank. First Bank filed a declaratory relief action and the trial court granted its summary judgment motion, holding that the liens had equal priority. East West Bank appealed and the court of appeal affirmed.

California has a modified “first in time, first in right” system of lien priorities, operating under a “race-notice” theory set out in [CC §1214](#). A bona fide purchaser, having paid valuable consideration and recorded first, has neither actual nor constructive notice of a previously created interest. Indexing alone, while statutorily required, does not impart constructive notice—a property must be *both* properly recorded and indexed under statute to provide constructive notice to a subsequent purchaser. Indexing and recording are distinctly separate functions and “it would disrupt the statutory scheme to make priority turn on the random act of indexing,” particularly when that act is out of the lender's control. 199 CA4th at 1317. The court of appeal construed the 4-hour indexing spread as ineffective to give constructive notice to either bank or to any other subsequent purchaser or mortgagee. Because both trust deeds were recorded at the same time, given the 8:00 a.m. time stamp, neither bank was a subsequent purchaser.

COMMENT: See Professor Roger Bernhardt's “Midcourse Corrections” column, on p 11 of this issue, for further comments on *First Bank v East W. Bank*.—Eds.